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SUBJECT: (C) ZHEJIANG: FACTORY CLOSURES RAISE SOCIAL STABILITY CONCERNS

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CLASSIFIED BY: CHRISTOPHER BEEDE, POL/ECON CHIEF, US CONSULATE
SHANGHAI, DEPARTMENT OF STATE.
REASON: 1.4 (b), (d)

Summary

1. (C) Social and political analysts in Zhejiang Province said the province's economy may recover from the current financial crisis (Refs A and B), but factory closures could result in social unrest, particularly as Lunar New Year approaches. Zhejiang-based observers worry that the Central Government's economic policy responses have been inadequate, and they said the upcoming Central Economic Work Conference will be critical to address the problems. Poloff's visit to Shaoxing, the epicenter of Zhejiang's economic downturn (Ref A), demonstrated the degree to which the province's textile manufacturing base has collapsed. Many migrant workers already have returned home for their annual Lunar New Year visit, including many unemployed workers who have been sent home by local governments concerned about social stability. Whether or not there will be enough jobs in cities like Shaoxing to support migrant workers after the holiday remains an open question, our contacts said. Rural experts warned that the countryside could experience social unrest due to an influx of unemployed migrant workers. End Summary.

The Plight of Zhejiang's Manufacturers

2. (C) Contacts in Hangzhou, Zhejiang's provincial capital, and Shaoxing told Poloff during a December 2-4 visit they are concerned about the possible social impact of the economic slowdown in East China. Ye Hang, an economics professor at Zhejiang University, said on December 2 that Zhejiang's exporters continue to be hit hard by the global economic slowdown (Refs A, B, and previous), and factory closures have

become commonplace. According to Ye, Zhejiang's exporters began to face serious problems in late 2007 when small- and medium-sized enterprises (SMEs) struggled to cope with new domestic economic policies, including renminbi (RMB) appreciation and the elimination of the export tax rebate. Ye believes the Labor Contract Law (LCL) did not have a significant impact on companies' economic difficulties, but in sectors such as the textile industry, where profit margins are small, any cause of rising costs is a contributing factor.

13. (C) Beginning in June 2008, Ye said, Zhejiang and other manufacturing areas felt the effects of China's tighter monetary policy, which began to hurt not only SMEs but larger companies as well (see also Ref A). Facing liquidity problems, larger companies in Zhejiang began to amass mounting debt, and factories started to close in Hangzhou, Shaoxing, and Yiwu. In October, Ye stated, suppliers of the larger firms also started to fail, leading to more light industry factory closures.

Jianglong's Fall From Grace

14. (C) Ye cited the case of Shaoxing's Jianglong Group as an example of the impact on suppliers. The boss of Jianglong Group -- a textile firm that employed 4,000 workers and posted a profit of USD 14 million last year -- locked the factory and fled the province after the company could not pay its rising debts. On November 3, the Los Angeles Times reported on the Jianglong closure, highlighting that as many as 300 of the company's suppliers would not be paid as a result. Since early November, more factories -- big and small -- have closed in Zhejiang, Ye said.

Not All Cities Are The Same

15. (C) Ye was quick to point out that not all cities in Zhejiang have been affected equally by the economic downturn. Shaoxing is representative of coastal China's economic problems because it is major textile producing center, but Yiwu faces brighter prospects because it is more diversified in both its product lines and export destinations (see Ref C). In a conversation together with Li Xuhang, Vice Mayor of Yiwu, and Zhou Ying, Vice Director of the Shaoxing Foreign Affairs Office, in Shanghai on November 28, Poloff asked about the economic impact on the two cities. Zhou acknowledged that several large factories have closed in Shaoxing, whereas Li told Poloff Yiwu's commodity product line somewhat insulated the city from slowing external demand, reiterating his view that "people will always need socks." (Note: Yiwu is a world-leading manufacturer of socks. End Note.)

Policy Responses to Date Inadequate

16. (C) Several of these Zhejiang-based contacts stated that the Central Government's policy responses to date have been inadequate. The Central Government's economic stimulus package, for example, may address some "short-term" infrastructure needs, but it does not address the core problem, which is a low rate of domestic consumption, Ye said. Economists in Zhejiang paid close attention to President Hu Jintao's comments during a November 29 meeting of the CPC Political Bureau when Hu reportedly warned that China is losing its competitive edge (Ref D), Ye said, and the upcoming Central Economic Work Conference will be critically important to address the growing economic and social problems in manufacturing centers.

17. (C) The Central Government is paying particularly close attention to Zhejiang, and Premier Wen Jiabao visited the province -- including Shaoxing and Yiwu -- in late November (Ref E), but contacts criticized the visit because they said Wen did not see the "real situation." Wen Kejian, an independent journalist, summarized the views of many others when he told Poloff on December 3 that "the Premier only visited the big

companies -- he didn't see the people's problems." The economic stimulus package might provide some economic benefits but it will not be useful for pacifying possible social unrest, Wen Kejian said, adding that official unemployment statistics grossly underestimate the scope of Zhejiang's economic crisis since migrant workers are not included in the figures as they technically still are rural residents.

Shaoxing: When a Boom Town Turns Into a Ghost Town

18. (C) Poloff visited Keqiao, known as Shaoxing's "textile city," with Wen Kejian on December 3. At the Qinfangcheng market, there was little foot traffic and few foreign buyers. One salesman said his business is managing to stay afloat because he is exporting to Africa and Latin America and already has orders, but prospects for next year may not be good. A pedicab driver said fewer foreigners are going to Keqiao to place orders, and he and other service sector workers are worried about their resulting falling incomes. A factory owner said several nearby factories have closed in recent months, and his operation is barely holding on. Keqiao was eerily quiet for an area known to be a hub of economic activity. Poloff also visited the Tianlong Factory where 4,000 - 5,000 migrant workers were employed until recently but which now sits dormant. The notable absence of factory and traffic noise and lack of pedestrian traffic was further evidence of the downturn.

19. (C) Shi Xiaoyu, a Shaoxing stockbroker, predicted the economic situation would worsen in 2009, as slowing internal and external demand hurts light manufacturers. Shi expressed concern that Shaoxing's economic plight will lead to social instability. One likely cause of instability, Shi said, is that local governments are strapped for cash, and they need more money to prop up businesses and keep the economy going. The only means for local governments to earn money is to illegally confiscate land and sell it, Shi said, adding that he is concerned confrontations between the government and local residents whose land is taken are increasingly likely in the current environment. Shi and Wen Kejian told Poloff they also are interested to see how Zhejiang taxi drivers react to the economic slowdown, as drivers now believe Chongqing Party Secretary Bo Xilai's willingness to negotiate with drivers in that city legitimized the grievances of drivers elsewhere (Ref F).

Migrant Workers Headed Home Early

110. (C) Most of the focus on the social impact of the economic crisis, however, continues to be on migrant workers (see also Ref G and H), many of whom already have departed early for their Lunar New Year holiday (which does not begin until late January). Contacts disagreed with the provincial government's contention that most of Zhejiang's migrant workers are remaining in the province (Ref B), stating that a mass exodus is underway.

Feng Gang, a Zhejiang University sociology professor, said anecdotal proof of the departures will be evident in mid-January when train stations experience significantly fewer crowds than normal prior to Lunar New Year. Wang Xiaozhang, a sociology professor who specializes in migrant worker issues, agreed, stating that it is not only the manufacturing sector that has been affected by the economic slowdown, but migrants previously employed in Hangzhou's service sector also are going home early because falling consumption is affecting restaurants, tea houses, and hotels. Migrant workers who currently do not have good job prospects are choosing to go home early for the holiday, Wang said.

111. (C) While some migrant workers are able to choose when to leave, others are being pushed out. According to Ye Hang, in many cases, factory bosses are paying off workers and telling them to go home. In other cases, such as the Jianglong example, bosses are closing the factory and skipping town, leaving local governments with the burden of paying workers. In Shaoxing, Ye said, the local government has spent approximately RMB 500

million (approximately USD 70 million) in recent months to pay workers' salaries and send them home quietly. For the sake of social stability, local governments do not want unemployed migrant workers to hang around in cities, Wang Xiaozhang said. Added Zhuang Daohe, a Zhejiang lawyer: "Government officials want to get the malcontents out as quickly as possible."

A "February Crisis" in Zhejiang?

¶12. (C) Contacts said it remains unclear what will happen after the Lunar New Year. Responding to Poloff's question about a November report in the Hong Kong-based Dagongbao on a possible "February crisis," Wen Kejian said he believes Zhejiang might reach a crisis point if migrant workers cannot find jobs. Wang Xiaozhang said he does not think there will be large-scale upheaval in the province in February, but he believes there may be protests by unemployed workers in different places. Feng Gang added that discontent among taxi drivers and other service sector workers could lead to unrest in the coming months, and Wen Kejian said university graduates facing poor job prospects also may more openly voice their concerns.

Uncertainty in the Countryside

¶13. (C) Several contacts also expressed concern about the social and economic impacts of migrant workers returning to the countryside. Huang Zuhui, Dean of the China Academy for Rural Development (CARD) at Zhejiang University, said social instability in the short-term is not likely because many migrants were able to save enough earnings prior to going home. If migrants are unable to find jobs after the Lunar New Year, however, rural areas in Zhejiang Province, as well as those provinces that send migrants to Zhejiang, are likely to encounter two significant problems: (1) unemployed migrant workers in the countryside will not want to resume farming, resulting in an idle, restive segment of the rural population, and (2) rural residents will lose the benefit of their relatives' migrant worker remittances, which will be a significant financial loss and potentially a source of social unrest. (Note: In Zhejiang, Huang estimated that 85 percent of rural incomes are from non-farm employment. End Note.)

¶14. (C) Huang said the economic slowdown and the return of migrant workers to the countryside is exactly the reason why the CPC Central Committee took the correct step during the Third Plenum to liberalize transfer of land use rights but not allow for privatization of land (Refs I and J) because migrants can return to the countryside more easily than if they had been allowed to sell their land. The Central Government's error in judgment, however, is that in reality, migrant workers who have been living in coastal China's urban centers for several years have neither the desire to return to farming nor the willingness to invest in agricultural inputs, Huang stated. It matters little, therefore, whether migrant workers have land in the countryside or not -- they still will be upset if they cannot find non-farm employment, he warned.

Comment

¶15. (C) Officials in Zhejiang Province have regularly expressed their concerns about the economic downturn in recent months. Not every city in the province faces the same problem -- Shaoxing may be an extreme case because of the city's heavy reliance on the textile sector. Our contacts appear increasingly worried, however, that Zhejiang's economic problems could result in social instability of some form or another. End Comment.